

Telecommunications Act of 1996 (the "Telecom Act") means the comprehensive legislative amendments to the Communications Act of 1934, adopted by Congress and signed into law by President Clinton on February 8, 1996, including Section 276 which specifically addresses the pay telephone services such as those provided by the Company and discussed herein.

#### General

The Company is one of the largest independent operators of public pay telephones in the United States, on the basis of number of public pay telephones in service. Since installing its first public pay telephone in 1985, the Company's core public pay telephone business has grown to an installed base, as of December 31, 1996, of approximately 38,500 public pay telephones in 41 states and the District of Columbia.

The Company owns, operates, services and maintains a system of independent public pay telephones and inmate telephones. Its public pay telephone business generates revenues from coin calls and non-coin calls such as calling card, credit card, collect and third-party billed calls made from its telephones. The Company has historically grown through acquisitions of public pay telephones from independent operators. Since 1990, the Company has acquired over 33,000 public pay telephones from 27 independent public pay telephone operators. The Company, in the past, has utilized its size and experience in integrating acquisitions to continue expanding its public pay telephone business and it may do so again. However, in 1995 and 1996 the Company did not acquire additional public pay telephones from external sources although it may consider attractive acquisition opportunities as and when they arise in the future. Currently, the Company is focusing on improving its existing pay telephone operations with the intention of increasing its cash flow, improving operating efficiency, increasing balanced internally generated growth and returning to profitability. The Company grows internally by entering into contracts for the installation of public pay telephones in locations where the Company believes there will be significant demand for public pay telephone service, such as convenience stores, grocery stores, service stations, shopping centers, hotels, restaurants, airports and truck stops. The Company's nationwide presence in the public pay telephone market makes it an attractive supplier of public pay telephone services for companies whose operations are regional or national. The Company is seeking to achieve balanced internal growth by increasing the number of public pay telephones with both (i) local and regional accounts and (ii) large national corporate accounts. The Company believes that substantially all of its public pay telephones, including its acquired public pay telephones, are in high traffic locations.

Management believes that the Company's long-term industry experience, nationwide presence and superior level of field and customer service are primary competitive strengths of the Company. As a high volume consumer of long-distance telephone service, the Company has been able to negotiate favorable terms and conditions from operator and long-distance telephone service providers such as

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The Company believes that this increase can be attributed, in part, to emphasis on maintenance programs which have improved the up-time of the Company's phones, the implementation and promotion of new coin calling programs and the Company's continued efforts to remove low revenue phones. Coin revenue decreased by 1.2% to approximately \$78.4 million in 1995 as compared to \$79.4 million in 1994. Although the Company's installed public pay telephone base increased to an average of 39,200 phones in 1995 compared to 38,000 phones in 1994, coin revenue on a per phone basis decreased approximately 4.3% in 1995 when compared to 1994.

While the Company is currently experiencing positive trends in coin revenue on a per phone basis, the Company believes that the number of coin calls made at its public pay telephones may remain flat or decrease over time. The Company believes that, among other things, the decrease will primarily result from the increased usage of alternative methods of calling such as prepaid calling cards and wireless technologies and the operation of more public pay telephones in closer proximity to the Company's telephones. The Company also believes that these decreases may be offset, over time, by increases in local coin call rates as a result of potential regulatory changes, although there can be no assurances.

On November 8, 1996, the Federal Communications Commission (the "FCC") issued its final order on reconsideration (the "Order") setting forth and affirming regulations implementing Section 276 of the Federal Telecommunications Act of 1996, previously issued on September 20, 1996. As a result of an appeal of the Order, the ultimate implementation and details of the Order are subject to the outcome of an action pending before the United States Court of Appeals for the District of Columbia. See "Business - Public Pay Telephone Industry Overview" and "Business - Regulation". The regulations in the Order, among other things, set forth a plan for the deregulation of local coin calling rates by October 1997. The Order allows states to request modification or exemption from such deregulation upon a detailed showing in support of such request by the state. Although neither the Company nor the industry can predict exactly what will happen in such a deregulated environment, trends indicate that there should be a move by the public pay telephone operators toward increased local coin calling rates in states where deregulation is implemented. This trend is evidenced by the fact that five states (Iowa, Nebraska, Wyoming, Michigan and South Dakota) have deregulated local coin calling rates and four of those five states now have market based local coin calling rates of \$0.35. In addition, Illinois and Wisconsin, although still under regulation, have also increased their local coin calling rates to \$0.35 through approval of rate/tariff applications filed by pay telephone operators in such states.

Non-coin revenue is derived from calling card calls, credit card calls, collect calls and third-party billed calls placed from the Company's public pay telephones and inmate telephones. During the second quarter of 1995, the Company

signed a contract with AT&T to act as its primary national operator service provider. Prior to the execution of this agreement, non-coin calls were routed through the Company's private label operator service program. The Company uses its private label operator service or a third-party operator service provider based on which service the Company believes nets it the highest gross margin from the call. The Company records as revenue the total amount the end user pays for the call (net of taxes) when the call is completed through the Company's private label operator service. In contrast, when the call is completed through the third-party operator service provider, the Company records as revenue the amount it receives from the third-party operator service provider which represents a negotiated percentage of the total amount the caller pays for the call. In May 1996, AT&T began paying a specified per call amount for interLATA (800) dial-around calls as opposed to a percentage of the revenue generated by those calls. The Company estimates that the impact on non-coin revenue of the change in the compensation structure under the AT&T contract was approximately \$3.7 million for the year ended December 31, 1996.

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In addition to the change in compensation under the AT&T contract, the Company is continuing to experience a shift in call traffic from 0+ calls, for which the Company receives a percentage of the revenue generated by those calls, to access code calls for which the Company receives a flat rate per phone or per call compensation amount. Due to aggressive advertising campaigns by long-distance companies promoting the use of access code calls, the Company believes that the decrease in non-coin revenue due to the changes in call traffic patterns is likely to continue. The Company believes that this decrease in non-coin revenue will be offset by changes in the amount of compensation received by the Company for such calls, as required under the FCC Order. Under the Order, in addition to the change in compensation received by the Company for access code calls, the Company will also begin receiving compensation for (800) subscriber calls. The Order mandates dial-around compensation to public pay telephone providers for both access code and (800) subscriber calls at a flat-rate of \$45.85 per pay telephone per month beginning November 6, 1996. This flat rate will be effective through October 6, 1997, at which time, compensation will begin on a per call basis at a rate of \$0.35 per call or such other rate negotiated by the pay telephone provider and the carriers. The Company estimates the impact of this flat-rate compensation on the Company's earnings before interest, taxes, depreciation and amortization, subject to possible changes resulting from the appeal of the Order, to be in excess of \$12 million on an annualized basis.

Non-coin revenue represented approximately 38.1%, 43.3% and 48.9% of total revenues from continuing operations in 1996, 1995, and 1994, respectively. Revenue from non-coin calls decreased by 20.6% to \$47.6 million, compared to 1995. Non-coin revenue decreased by approximately 23.2% to \$59.9 million in 1995 as compared to 1994. These decreases are primary attributable to: (i) the method

of recording revenue for certain non-coin calls as a result of the change to AT&T as the Company's primary national operator service provider; (ii) the change in the Company's compensation structure under the AT&T contract; and (iii) the decrease in the number of inmate telephone lines operated by the Company.

During 1996, 1995 and 1994, the Company operated approximately 2,000, 3,000 and 4,000 inmate telephone lines, respectively.

### Operating Expenses

Operating expenses include telephone charges, commissions, field service and collection expenses and selling, general and administrative expenses. Telephone charges consist of local line charges paid to LECs which include costs of basic service and transport of local coin calls, long-distance transmission charges and network costs and billing, collection and validation costs. Commissions represent payments to Property Owners for revenues generated by public pay telephones located on their properties. Field service and collection expenses represent the costs of servicing and maintaining the telephones on an ongoing basis, costs of collecting coin from the telephones and other related operational costs. Selling, general and administrative expenses primarily consist of payroll and related costs, legal and other professional fees, promotion and advertising expenses, property, gross receipt and certain other taxes, corporate travel and entertainment and various other expenses. Total operating expenses were approximately 84.5%, 85.8% and 85.5% of total revenues from continuing operations for the years ended December 31, 1996, 1995 and 1994, respectively.

The switch by the Company to a third-party operator service resulted in a decreased revenue base due to the method of recording revenue for calls made through that service as compared to calls placed through the Company's private label operator service program (see above). As a result, certain operating expenses as a percentage of revenues increased in 1996 compared to the same periods in 1995 and 1994.

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Telephone charges decreased as a percentage of total revenues from continuing operations to 31.3% for the year ended December 31, 1996, compared to 35.2% for the same period in 1995. Telephone charges were approximately 42.4% of total revenue for 1994. The decrease in telephone charges is primarily a result of regulatory changes and competition within the local intraLATA service market which began in the third quarter of 1995. Telephone charges for 1995 include approximately \$1.0 million of additional bad debt reserves related to both the inmate and pay telephone operations.

In addition to the items previously noted, the decrease in telephone